

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for rate
increase in Charlotte County by
Utilities, Inc. of Sandalhaven.

DOCKET NO. 020409-SU
ORDER NO. PSC-03-0602-PAA-SU
ISSUED: May 13, 2003

The following Commissioners participated in the disposition of this matter:

LILA A. JABER, Chairman
J. TERRY DEASON
BRAULIO L. BAEZ
RUDOLPH "RUDY" BRADLEY
CHARLES M. DAVIDSON

NOTICE OF PROPOSED AGENCY ACTION
ORDER GRANTING RATE INCREASE

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein, except for the interim rate increase, the rate reduction after the expiration of the four-year amortization period for rate case expense, and the show cause decision, is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

I. CASE BACKGROUND

Utilities, Inc. of Sandalhaven (Sandalhaven or utility) is a Class B wastewater utility providing service to approximately 827 customers in Charlotte County. Sandalhaven is a wholly-owned subsidiary of Utilities, Inc. Water service is provided by Charlotte County Utilities.

In 1995, we were given jurisdiction over privately-owned water and wastewater utilities in Charlotte County as a result of a resolution by the Board of County Commissioners of Charlotte County. Sandalhaven was granted a grandfather certificate by Order No. PSC-95-0478-FOF-SU, issued April 13, 1995, in Docket No. 941341-SU. In 1999, we approved the certificate transfer of Sandalhaven Utility, Inc. to Utilities, Inc. of Sandalhaven by Order No. PSC-99-2114-PAA-SU (Transfer Order), issued October 25, 1999, in Docket No. 981221-SU.

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This utility has never had a full rate case, however, the utility's rate base was established for the transfer as of August 31, 1998, by the Transfer Order.

On August 16, 2002, the utility filed for approval of final and interim rate increases, pursuant to Sections 367.081 and 367.082, Florida Statutes. However, the information submitted did not satisfy the minimum filing requirements (MFRs) for a general rate increase. Subsequently, on October 1, 2002, the utility satisfied the MFRs and this date was designated as the official filing date, pursuant to Section 367.083, Florida Statutes. The utility requested that we process this case under the proposed agency action (PAA) procedure. The 5-month statutory deadline for processing this case was March 1, 2003.

By letter dated January 31, 2003, Sandalhaven filed a 30-day waiver of the 5-month statutory deadline for processing this rate case. This extended the 5-month deadline for consideration of the PAA decision to March 30, 2003. Subsequently, by letter dated February 25, 2003, Sandalhaven filed for an additional 30-day waiver of the 5-month statutory deadline for processing this rate case. This extended the 5-month deadline for consideration of the PAA decision to April 29, 2003.

The test year for interim and final purposes is the historical test year ended December 31, 2001. In its MFRs, the utility reported operating revenues of \$221,904 and a net operating loss of \$16,329. By Order No. PSC-02-1703-PCO-SU, issued December 6, 2002, Sandalhaven was granted interim revenues of \$276,505, which represents an increase of \$54,601 or 24.61%. The utility's requested final revenues are \$336,914, representing an increase of \$115,009, or 51.83%.

This Order addresses the revenue requirement and rates approved herein on a prospective basis. The Commission has jurisdiction pursuant to Sections 367.081 and 367.082, Florida Statutes.

II. DISCUSSION OF ISSUES

A. Quality of Service

Pursuant to Rule 25-30.433(1), Florida Administrative Code (F.A.C.), in every water and wastewater rate case, the overall quality of service provided by a utility shall be determined by evaluating three separate components of water and wastewater operations. These components are (1) the quality of the utility's product; (2) the operating conditions of the utility's plant and facilities; and, (3) the utility's attempt to address customers' satisfaction. The rule further states that sanitary surveys, outstanding citations, violations, and consent orders on file with the Department of Environmental Protection (DEP) and the County Health Department over the preceding three-year period shall be considered, along with input from the DEP and health department officials and consideration of customer comments or complaints. These components are analyzed below.

Sandalhaven provides only wastewater service in Charlotte County and is located in Englewood, Florida. Charlotte County provides the water service to this area. Its customer base consists of multi-family residential, single-family residential, commercial, and general service customers.

The wastewater treatment plant is located adjacent to the Fiddler's Green Condominium II. The plant is a 150,000 gallons per day (gpd) extended aeration domestic wastewater treatment plant. This facility processes the inflowing waste and directs it to the reclaimed water processing system of the plant. The reclaimed system consists of a filtration system and a high-level chlorination system. The reclaimed water is then transported, via wastewater distribution line, to a reuse holding pond which is located at the Wildflower Country Club Golf Course. In addition, this facility has a collection system which consists of collection mains and 11 lift stations that are located throughout the service area.

We reviewed, from the MFRs filed by the applicant, the following: system maps, chemicals used, chemical analyses, monthly operation reports (MORs), DEP permits, wastewater compliance inspection reports, notices, field employees' records, vehicle, and

customer complaint logs maintained by the utility. We also researched whether any customer complaints related to this utility were filed with the Division of Consumer Affairs. Based on our review, everything appeared to be in satisfactory condition. DEP has jurisdictional authority regarding compliance with environmentally related wastewater rules and enforcement of those rules. According to DEP, Sandalhaven does not have any consent orders or notices of violations filed against it.

Quality of the Product

The plant MORs and chemical analyses which the utility submits to DEP monthly were reviewed. The information contained in these records indicates that the quality of the plant's effluent meets DEP standards. In addition, DEP last reviewed this facility on April 4, 2002. The results of that inspection indicate that the plant's finished product met DEP's standards. Therefore, we find that the finished product is satisfactory.

Operating Condition of the Plant and Facilities

A field inspection of the utility's treatment plant, collection, and reclaimed water systems was conducted by our staff. The investigation revealed that Sandalhaven's plant appeared to be in compliance with Department of Health and DEP rules and regulations. In addition, the DEP inspector that evaluates this plant stated that, currently, the operating conditions of the treatment plant, reclaimed water, and collection systems meet DEP's standards. Based on the above, we find that the operating condition of the utility's facilities is satisfactory.

Customer Satisfaction

On December 10, 2002, our staff conducted a customer meeting in the utility's service territory in Englewood, Florida. Approximately 19 customers attended and six signed up to speak at the meeting. The customers' concerns were the rate increase, plant odor, the possibility of future plant expansion, and road degradation.

After the meeting, our staff requested a written response from the utility regarding the concerns expressed by the customers at

the customer meeting. The concerns of the customers, response from the utility, and our comments regarding those concerns are as follows:

Plant Odor

Customers at the Fiddler's Green Condominium II Association (Association) complained that sometimes the odor coming from the plant was unbearable and offensive. The odor is worse during the peak season when the majority of the residents are present.

In its response, the utility stated that the plant's previous owners did not operate or maintain the plant adequately. However, after the utility acquired the plant, it made numerous improvements to reduce odors. The utility increased aeration and repaired and installed additional blowers. In 2001, the utility terminated the process of stabilizing sludge on-site prior to transport and disposal, which reduced ammonia off-gassing. Also, in 2001, Sandalhaven started adding histosol, an odor control product, to its equalization tank to reduce the smell of the raw wastewater at the front of the plant.

During our staff's investigation, no excessive odors coming from the plant were apparent. However, the investigation was not conducted during the peak season. We have reviewed the actions the utility took to address excessive odors and it appears that those actions are reasonable and should resolve this issue.

Future Growth

The customers wanted to know if the utility had plans for future expansion of the plant and the effects that those plans would have on current treatment facilities.

In its response, the utility stated that there are no specific plans at the current time to expand or construct additional treatment plant. In addition, the utility indicated that during the peak three months, the average flow of the plant had only increased 10% since 1999. Therefore, the utility has no immediate need to expand the plant.

Our analysis of the utility's projected growth indicates that the service area will grow at a rate of 5 equivalent residential connections (ERCs) per year and the used and useful adjustment reflects that growth allowance. DEP rules require that utilities prepare a plan for expansion when plant reaches 80% capacity. Further, because the need for plant expansion is based on development growth, it would be speculative to predict any specifics regarding growth beyond the 5-year growth allowance.

Road Degradation

The president of the Association stated that several customers in the community expressed concern regarding the sludge hauling trucks gradually degrading the quality of the entrance road. The treatment plant access road travels through both of the Fiddler's Green Condominium complexes (I and II). The customers stated that the two homeowners' associations incur the cost of maintaining the road and that the utility does not seem to be concerned about the wear and tear that the sludge hauling trucks place on the access road to the plant.

The utility indicated that it sent a letter to a representative of the Association to discuss the issues of repairing the road, but no response was received. In addition, the utility stated that it would be willing to meet and discuss the issue with the condominiums' respective boards.

We believe that the two parties should meet to discuss future reimbursement for road repair. Further, prudent costs paid by the utility can be recovered through rates in the future.

Summary

Based on our review of the wastewater treatment, collection, and the reclaimed water systems, we find that all systems are operating properly and are in compliance with DEP standards. Further, we find that the utility is actively attempting to address the major areas of customer concern. For these reasons, the quality of service provided by Sandalhaven is satisfactory.

III. RATE BASE

A. Organization and Franchise Costs

Organization Costs

In our review of the prior transfer audit, as of the date of the transfer to Utilities, Inc. of Sandalhaven, the utility reflected a balance in organization costs of \$17,021. It also had a reported balance in accumulated depreciation equal to the plant account and, thus, the account was fully depreciated. Those balances were not addressed in the transfer audit report as they had no impact on rate base. In reviewing the transfer audit work papers, the pre-transfer organization costs related to earlier acquisition costs. We find that it is not prudent for these amounts to be included in plant and, thus, the continued depreciation of these intangible assets is inappropriate. Therefore, the \$17,021 balance shall be removed from rate base.

After our approval of the transfer, Utilities, Inc. of Sandalhaven recorded additional organization costs of \$59,900. Pursuant to Audit Exception No. 3, these costs included \$9,900 for capitalized labor for Water Services Corp. (WSC) employees. WSC is a service company for the parent company, Utilities, Inc. The remaining \$50,000 was a commission paid to Kace, Inc. (Kace) for the sale of the utility.

In its response to Audit Exception No. 3, the utility states that Kace was a company hired by Utilities, Inc. to perform acquisition services, such as finding assistance and due diligence work. The utility said that Kace was hired to perform these services for three acquisitions in Florida, including Sandalhaven and that the \$50,000 commission paid to Kace on March 3, 1999, was for the acquisition of Sandalhaven and was not paid until the closing of the acquisition.

Further, the utility states that the remaining costs charged to organization costs consist of capitalized time for two executives and the regional manager of Sandalhaven. The utility states that this time was used to "secure easements on property, defend legalities of the acquisition, etc."

Per the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA), the organization account shall include all fees paid to federal or state governments for the privilege of incorporation and expenditures incident to organizing the corporation and putting it into readiness to do business.

In addition, the USOA states that the Utility Plant Acquisition Adjustment account includes the difference between the cost of the purchasing utility of plant acquired and the original cost of the property acquired less accumulated depreciation, accumulated amortization, and contributions in aid of construction (CIAC) at the time of purchase. We interpret the term "cost of acquisition" to include any consideration paid, plus any other costs incurred related to or given for the purchase of the assets.

We find that the expenses discussed above shall not be recorded as organization costs. First, the expenses are acquisition costs and inappropriately treated as organization costs. Second, the expenses should be borne by the stockholders of Sandalhaven's parent company because the purchase of Sandalhaven was not the ratepayers' decision, nor has Sandalhaven demonstrated how the customers have benefitted from this transaction. Because these expenses are directly associated with the change of ownership, they shall be recorded as acquisition costs.

We have previously disallowed acquisition costs recorded on a utility's books as organization costs. See Order No. PSC-93-1713-FOF-SU, issued November 30, 1993, in Docket No. 921293. See also Order No. PSC-98-0524-PAA-SU, issued April 16, 1998, in Docket No. 971065. Thus, the additional balance of \$59,900 for organization costs shall be removed from rate base. Adding the adjustment for the pre-transfer balance of \$17,021 to the \$59,900 results in a decrease to organization costs of \$76,921. Corresponding adjustments shall also be made to decrease accumulated depreciation by \$20,866 and depreciation expense by \$1,920.

Franchise Costs

In addition to organization costs, the utility had a pre-transfer balance of franchise fees of \$12,478, with an equal amount of accumulated depreciation. Based on our review of the transfer

audit, this balance of franchise fees was also related to acquisition costs. Consistent with our finding regarding the pre-transfer organization costs, we find that the prior franchise costs shall also be removed from rate base.

Furthermore, after our approval of the transfer, the utility recorded additional franchise fees of \$12,591. According to Audit Exception No. 3, supporting documentation was requested but never received for the \$10,763 recorded for adjusting journal entries to the franchise account. We reviewed the remaining \$1,828 in franchise costs which related to establishing the territory of the utility and those amounts appear reasonable. Thus, \$10,763 in franchise fees shall be removed due to lack of supporting documentation.

Based on the above, the total adjustment to franchise fees shall be \$23,241. Corresponding adjustments shall also be made to decrease accumulated depreciation and depreciation expense by \$13,258 and \$580, respectively.

Conclusion

Based on the above, Sandalhaven's organization and franchise costs shall be reduced by \$76,921 and \$23,241, respectively, to reclassify them as below the line acquisition costs, prior owner, and undocumented costs. Corresponding adjustments are also necessary to accumulated depreciation and depreciation expense as follows:

	<u>Accumulated Depreciation</u>	<u>Depreciation Expense</u>
Organization Costs	\$20,866	\$1,920
Franchise Costs	13,258	580

B. Adjustment to AFUDC

AFUDC is an accounting entry designed to permit a utility to recover, over the life of an asset, the cost associated with financing eligible construction activities. AFUDC is capitalized

in lieu of interest, and capitalized AFUDC recognizes that the overall capital structure provides funding for construction projects, not just debt financing. Rule 25-30.116, F.A.C., specifies the requirements necessary to capitalize AFUDC and also the methodology used to determine the AFUDC rate. Subsection 5 of that rule states that "[n]o utility may charge or change its AFUDC rate without Commission approval."

According to our staff auditors, Sandalhaven capitalized \$9,881 of AFUDC for the calendar years of 1999-2001. However, the utility does not have our approval to capitalize AFUDC. While we have granted permission to accrue AFUDC for other Florida subsidiaries of Utilities, Inc., Sandalhaven has not requested, nor received, an approved AFUDC rate.

In 2000, the utility accrued \$7,374 in Account 380, Treatment and Disposal Equipment, and an additional \$2,255 in Account 354, Structures and Improvements, and \$252 in Account 380 in 2001. We find that these amounts, totaling \$9,881 in year-end plant, and \$35 and \$622 of year-end accumulated depreciation for water and wastewater, respectively, shall be removed from the utility's books.

Since rates are set using an average rate base, one half of the amount for 2001, or \$1,254, shall be removed from average test year plant. Including the \$7,374 of average plant discussed above, a total of \$8,628 in capitalized AFUDC shall be removed from average test year plant. For accumulated depreciation, the utility accrued \$205 and \$417, a total of \$622, in Account 380 for 2000 and 2001, respectively. It also accrued an additional \$35 in Account 354 for 2001. Using the same averaging methodology as discussed above, \$18 and \$414, a total of \$432, in average accumulated depreciation, for Accounts 354 and 380, respectively, shall be removed. Depreciation expense for 2001 of \$35 in Account 354 and \$417 in Account 380, a total of \$452, shall also be removed.

C. Valuation of Land

In its MFRs, the utility reflects a \$225,000 value for the land on which the wastewater treatment plant is located. This land is made up of two parcels totaling 2.15 acres.

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In approving the transfer from Sandalhaven Utilities, Inc. to Utilities, Inc. of Sandalhaven, we reviewed the reasonableness of the requested land value of \$225,000. (See the Transfer Order.) We found that while the \$225,000 appraisal might be overstated due to dissimilar characteristics of the compared lots, the appraisal had been conducted by an unrelated party. Further, the order stated:

Because we were unable to determine the original cost of the land and the disparity between the properties, we find it appropriate to use the present appraisal in this case. However, the issue of the value of the land shall be revisited in a future rate proceeding.

For this rate case, we analyzed what the original cost of land was when the treatment plant was first placed into service. In order to do this, we attempted to research the history of these land parcels to the dates prior to the in-service date of the plant.

The utility plant is contiguous to the Fiddler's Green condominiums in Englewood. The land was originally part of a larger parcel transferred from Gasparilla Pines Association, Inc. to Eugene and Helene Schwartz, and Melvin and Vilma Steinbaum in 1979. SFSC, a Florida Partnership, bought the land in 1985. Fiddler's Green purchased the property from SFSC, a related party, in September 1987. Three corporations, Fiddler's Green Condominiums, Inc., Fiddler's Green Condominium Association, Inc., and Fiddler's Green Condominium Association II, Inc., each deeded ownership to Sandalhaven Utility, Inc. in September 1987. This was also a related party transaction, as the owner of Fiddler's Green was a major stockholder in Sandalhaven Utility, Inc.

The utility plant was placed in service in 1987, and construction began in at least 1985. In July 1990, the owners at that time had an appraisal performed that valued the land at \$225,000. The appraisers used, as a comparable site, waterfront property in Venice, Florida, which is 12 miles north of the plant location in Englewood. This appraisal was reaffirmed in August 1991. According to audit work papers developed in the 1998 transfer docket, the land was not recorded on the utility books until 1991.

Additional documentation obtained from the Charlotte County Clerk of the Court, and contained in the work papers for the audit performed in this docket, indicated that the land was sold by Fiddler's Green Condominium, Inc. on December 27, 1996, to Sandalhaven Utility, Inc. for \$70,000. Other county appraiser records indicate that the property was then resold on the same date, December 27, 1996, by Sandalhaven Utility, Inc. to CHP Utility, Inc., for \$70,000.

In an attempt to determine the reasonableness of the 1990 appraisal of \$225,000, the auditors in the 1998 transfer audit obtained a deed for comparable property sold in the Cape Haze subdivision in 1986. The Cape Haze subdivision is in the Sandalhaven service territory and is not waterfront property. The particular property was sold for \$40,000. The auditors noted that the utility property was 3.67 times as large, so the \$40,000 for the smaller property was grossed up to \$146,826, to represent a price 3.67 times greater.

In the 1998 transfer docket, the auditors concluded that the appraisal of \$225,000 was overstated because the land in Venice represented as comparable was, in fact, not comparable. The conclusion was that a value of \$146,966 was more reasonable because the comparison was with a piece of land in the service area and it was usually less expensive to purchase a larger tract as opposed to a lot.

Unaudited financial records of CHP Utility, Inc. as of October 31, 1998, indicate that the land was being carried on its books at \$70,000. Ten days later, on November 10, 1998, Charlotte County Property Appraiser records indicate that CHP Utility, Inc. gave a quit claim deed and a warranty deed for \$35,000 to Sandalhaven Utility, Inc. According to additional Charlotte County Property Appraiser records, the land was sold March 26, 1999, by Sandalhaven Utility, Inc. to Utilities, Inc. of Sandalhaven for \$100,000.

In the current rate case audit, the auditors conducted an extensive review of mortgage records and tax appraisal documents. The auditors stated in Audit Exception No. 1 that the land value should be no higher than \$35,000, which was the value based on the November 10, 1998 transfer from CHP Utility, Inc. to Sandalhaven Utility, Inc. The audit opinion also stated that the \$35,000

valuation is also close to the current tax appraisal. The utility initially responded to the audit exception by stating that they believed the value should be no less than the \$146,966 value placed on the land determined in the 1998 transfer docket.

In a rate proceeding for Poinciana Utilities, Inc., the utility purchased several tracts of land from a related developer party. We stated that:

[i]t is the utility's burden to prove that it has recorded its investment at the original cost when first devoted to public service and we do not believe that the Utility has met this burden for its recorded cost.

See Order No. 22166, issued November 9, 1989, in Docket No. 881503-WS.

Further, in a rate proceeding involving Orange and Osceola Utilities, Inc., we found that several related-party transactions had inflated the cost of the land. The land was transferred several times between 1974 and when it was first dedicated to public service in 1981. We found that since the record was silent as to what an arms-length price would have been in 1981, the land's value should be based on the last available arms-length price per acre in 1974, adjusted for inflation. See Order No. 17366, issued April 6, 1987, in Docket No. 850031-WS.

The Sandalhaven property was sold by CHP Utility, Inc. to Sandalhaven Utility, Inc. for \$35,000 in November 1998. As indicated previously, it appears to have been purchased for \$70,000 from Sandalhaven Utility, Inc. in December 1996. CHP Utility, Inc. was a not-for-profit entity comprised of existing service area ratepayers, and the 1998 purchase from the existing for-profit utility would qualify as an arms-length transaction. This date is more than 10 years after the date that the property was dedicated to public use.

To establish the value of land in an arms-length transaction, we have used appraisals valued as of the date the plant was dedicated to public service. Depending on the circumstances, we have accepted or rejected appraisals depending on whether the appraisals were based on equivalent land sales.

In a rate proceeding involving Rolling Oaks Utilities, Inc., we addressed the utility's purchase of 24 acres from a related development corporation. The land had previously been undeveloped, but the utility planned to place percolation ponds on the site in order to comply with a DEP requirement. Because the sale was not an arm's-length transaction and we could not rely on the utility's appraisal assumptions, we looked at the original cost of the land paid by the related party, adjusted for inflation, to determine the land's value. We adjusted the land account to reflect the appropriate land value. See Order No. 17532, issued May 8, 1987, in Docket No. 850941-WS.

We find that the value of the land on Sandalhaven's books shall be reduced. The utility has not provided any information in two separate dockets to show that the \$225,000 value of the land is representative of the value when the plant was first devoted to public service. Regardless of the appraisal values in 1990-1991, this value was determined more than five years after construction began. Thus, we find that the utility has not met its burden to prove the value of the land.

The November 1998 sale from CHP Utility, Inc. to Sandalhaven Utility, Inc. appears to be the most reasonable valuation and is the closest arms-length sales price to the date the plant was placed in service. We do not believe that the fact that this property had been sold for a higher price in earlier years is important because in some cases these were not arms-length transactions.

Our staff requested that if the utility intended to seek another valuation for the land, that a more accurate appraisal be obtained. By letter dated February 25, 2003, Sandalhaven filed for an additional 30-day waiver of the 5-month statutory deadline for processing this rate case to obtain an appraisal. By letter dated March 17, 2003, the utility stated that the appraiser's value was not substantially in excess of the \$35,000. Based on the above, we find that the value of the utility land shall be set at \$35,000, which is a reduction to the land value of \$190,000.

D. Accumulated Depreciation

Rate base was established for Sandalhaven as of August 31, 1998, in Docket No. 981221-SU. According to the staff auditors in Audit Exception No. 7, the utility did not record any depreciation or amortization of CIAC for September 1998, through December 1998. Utility schedules show only an increase of \$3,268 for accumulated depreciation for 1999. In addition, the depreciation rates used do not agree with the guideline lives pursuant to Rule 25-30.140, F.A.C. This rule requires water and wastewater utilities to maintain depreciation rates as we have prescribed, unless we specifically modify those depreciation rates. We find that restatement of the reserve account is necessary to properly state rate base for rate-setting purposes, and to do otherwise would overstate rate base.

We find that because Sandalhaven failed to depreciate its plant and amortize its CIAC, the ratepayers will be harmed if the reserve accounts are not corrected. Sandalhaven's last rate base was established by using rates we prescribed, so the utility was on notice that those depreciation rates were in effect. Further, the utility in this case made an adjustment to increase its rate base to reflect the amortization of CIAC it failed to record, but made no corresponding adjustment to correct the depreciation reserve account.

Field audit staff recalculated accumulated depreciation and accumulated amortization of CIAC for the period of September 1998 through December 2001 to reflect the correct amounts that were not reflected in the utility's calculations. The average accumulated depreciation listed in the utility's MFRs is \$565,289. The audit found that accumulated depreciation should be \$649,722, a difference of \$84,433. We find that the accumulated depreciation account shall be increased by \$84,433. As a result of the incorrect depreciation rates used by the utility, depreciation expense shall also be increased by \$15,949.

We recalculated the accumulated amortization of CIAC for the same period. The average of accumulated amortization of CIAC in the utility's MFRs was \$591,754. Staff auditors found that the actual average balance should be \$626,882, a difference of \$35,128. Therefore, we also find that the accumulated amortization of the

CIAC account shall be increased by \$35,128. Amortization expense of CIAC shall also be increased by \$11,461.

E. Allocation of Water Services Corporation

Utilities, Inc., the parent company, through its subsidiary Water Service Corporation (WSC), allocates common costs, including billing costs, to all of its subsidiary utilities, including Sandalhaven.

Per Audit Exception No. 2, the company included an allocation for Utilities Inc. of Florida's rate base in the general ledger to Sandalhaven but did not include an allocation of WSC's rate base. According to the staff audit of Utilities, Inc.'s affiliate transactions, the amount allocated to Sandalhaven is \$12,208. Based on the above, we find that rate base shall be increased by \$12,208.

F. Used and Useful Plant

The utility, in its filing, calculated the used and useful percentage for the wastewater treatment plant to be 66.22%. The utility requested that the used and useful percentages for land and the collection and reclaimed water systems all be considered 100%. Our analysis of the utility's used and useful plant is discussed below.

Wastewater Treatment Plant

In its filing, the utility calculated its used and useful percentage for the wastewater treatment plant by taking the sum of the annual average daily flows (AADF) of 70,792 gpd and a growth allowance of 19,615 gpd (14 ERCs x 5 years x 280 gpd). It then divided that total by the plant's DEP permitted capacity of 150,000 gpd AADF. The utility did not make any adjustments for inflow and infiltration (I&I) in its calculations. This resulted in a 60.27% used and useful percentage for wastewater treatment plant. Because the utility included its reclaimed water facilities in the subaccount with other wastewater treatment equipment, it used a composite rate to recognize the reclaimed water plant as 100% used and useful. The utility calculated a composite used and useful of

66.22% and applied it to plant, accumulated depreciation, and depreciation expense accounts.

In calculating its growth allowance, the utility used historical total company flows instead of ERC growth, which is not consistent with our practice in projecting future growth. As a result of the prior owner's improper record keeping, while it had wastewater flow data, the utility had only the most recent 3 years of customer growth data. The utility's consulting engineer stated that to use linear regression on 3 years of growth data would produce an illogical conclusion. Therefore, Sandalhaven used linear regression on 10 years of historical wastewater treatment flows to project the next 5 years of flows. The utility then took the 5-year total projected flows and subtracted that from the test year flows resulting in a growth allowance of (90,407 gpd less 70,792 gpd = 19,615 gpd). To back into the annual growth of 14 ERCs, the utility used 280 gpd for consumption per ERC (which is a design criterion), and a 5-year growth period per statute.

We used the same methodology as the utility to calculate used and useful but we find that several adjustments are needed. The first relates to a difference in the amount of test year AADF flows. The utility used 70,792 gpd but we calculated a different amount. We reviewed the utility's monthly operating reports, and performed a day-by-day count of the operator's daily logs. We recalculated the sum of the flows for the test year and find it to be 72,740 gpd.

The second difference deals with determining the average historical customer growth rate. We would normally use 5 years of historical customer growth data and apply linear regression; however, 5 years of data was not available. Therefore, we used the 3 years of available customer growth data which was contained in the MFRs. The data was averaged and the growth allowance was determined to be 5 ERCs per year.

The utility's methodology in estimating the ERC growth rate has several flaws. The first is that the utility's result of 14 ERCs per year is clearly excessive based on the most recent 3-year average. Second, using total flows improperly blends the impact of customer growth with weather fluctuations, consumption changes, and infiltration levels. The utility's method actually measures growth

in flows as opposed to ERC growth and could easily skew customer growth rates. For these reasons, we find that the 3-year simple average reflects a more accurate method to measure customer growth.

To determine the wastewater usage per customer we took the 72,740 gpd AADF and divided that by the test year number of ERCs (861 ERCs). The result is 84 gpd per ERC. The 861 test year ERCs was based on meter equivalents, pursuant to Rule 25-30.055, F.A.C. We find that using actual consumption per ERC is more accurate than a design criteria consumption factor, as it reflects what occurred during the test year. It also matches the AADF method used to determine the test year flows and permitted capacity of the plant. Based on our calculations, the growth allowance that shall be included in the used and useful calculation is 2,100 gpd.

Our method of calculating used and useful is consistent with Rules 25-30.431 and 25-30.432, F.A.C. Applying the above adjustments to the used and useful formula, we find that the wastewater treatment plant is 57.54% used and useful. After removing the reclaimed water facilities, the composite used and useful percentage is 49.89%.

We also reviewed the utility's wastewater treatment plant land. This land is made up of two parcels totaling 2.15 acres, on which the treatment facilities are located. Based on our review, the utility is fully utilizing the total amount of land and we agree with the utility that it shall be considered 100% used and useful.

Contribution Level of Plant

We analyzed used and useful on an engineering basis and calculated adjustments to rate base consistent with each of our methodologies. However, if you look at the engineering aspect of the test year equation in a vacuum, applying the used and useful adjustment to the utility's rate base presents an illogical result. There are two reasons for this. The first reason is that the used and useful equations do not include an estimate of consumption for the 148 ERCs that pay monthly guaranteed revenues. In its filing, the utility reflected those revenues above the line in calculating its requested revenues. Including the revenues but not incorporating the usage in the used and useful calculation clearly

creates a mismatch between the rate calculation and the used and useful revenue requirement. In order to reflect the proper amount of used and useful, this estimate shall be included in the test year flows included in the numerator of the equation, thus increasing the total used and useful percentage. However, this adjustment is not necessary as discussed below.

The second and most crucial aspect that was left out of the utility's used and useful analysis is the amount of CIAC included in the utility's rate base. The purpose of making a used and useful calculation is to remove from rate base any investment that the utility has in non-used and useful plant held for future customers. If non-used and useful plant is fully contributed, making a used and useful reduction to rate base would reduce rate base more than the book value originally included. Thus, a negative rate base impact would result.

An analysis of the utility's rate base components without land and working capital are shown below. Working capital is not subject to used and useful adjustments, and we find that land is 100% used and useful.

<u>Contribution Level</u>	<u>Per Utility</u>	<u>Per Commission</u>
Plant (w/o land)	\$1,685,206	\$1,588,023
Accumulated Depreciation	<u>(565,289)</u>	<u>(617,210)</u>
Net Plant	<u>\$1,119,917</u>	<u>\$971,413</u>
CIAC	(\$1,607,051)	(\$1,607,051)
Accum. Amort. of CIAC	<u>591,754</u>	<u>626,882</u>
Net CIAC	<u>(\$1,015,297)</u>	<u>(\$980,169)</u>
Rate Base	<u>\$104,620</u>	<u>(\$8,756)</u>
Original Non-used & Useful Adjustment	(120,350)	(147,701)
Rate Base Before Land & Working Capital	<u>(\$15,730)</u>	<u>(\$156,457)</u>

As the above table reflects, making any used and useful adjustment will penalize the utility, given the contribution level of the utility's plant. Based on the above, we find that a used and useful adjustment shall not be made in this case.

Inflow and Infiltration (I&I)

In its MFRs, the utility stated that I&I was not a factor; therefore, no adjustments were required. We used the customer billing analysis, which was part of the utility's filing, to determine the level of I&I. By using the data on the amount of water sold to customers and comparing it with the amount of wastewater treated, we determined that I&I is not an issue. Therefore, we agree with the utility that no adjustments are necessary.

Reclaimed Water System

Section 367.0817(3), Florida Statutes, states that all prudent costs of a reuse project shall be recovered in rates. The utility, in its filing, requested a 100% used and useful percentage for the reclaimed water system. We agree with the utility that the reclaimed water system is 100% used and useful.

Wastewater Collection System

The utility's customer base is primarily residential and multifamily units. A calculation for used and useful percentage of the collection system was not required because virtually all of the wastewater mains and lift stations were contributed by the developers. Therefore, we find that the wastewater collection system is 100% used and useful.

Summary

Based on the above, we find that making any used and useful adjustment will penalize the utility, given the contribution level of the utility's plant. Therefore no used and useful adjustments shall be made in this case.

G. Appropriate Working Capital

Rule 25-30.433(2), F.A.C., requires that Class B utilities use the formula method, or one-eighth of operation and maintenance (O&M) expenses, to calculate the working capital allowance. The utility has properly filed its allowance for working capital using the formula method. Due to the adjustments made to O&M expenses in

the preceding issues, a decrease of \$2,908 to the utility's requested working capital allowance of \$29,531 shall be made.

H. Appropriate Rate Base

Using the utility's MFRs with the adjustments made in the preceding issues, the utility's rate base is \$54,048.

IV. COST OF CAPITAL

A. Weighted Cost of Capital

In its MFRs, the utility used the debt and equity ratios of its parent, Utilities, Inc., to prorate Sandalhaven's share of the parent's capital. The utility then included the actual balance of Sandalhaven's customer deposits. Sandalhaven did not include any amounts for deferred income taxes in its cost of capital calculation.

In our audit of Utilities, Inc.'s affiliate transactions for the year ending December 31, 2001, the auditors recommended that the debt rates used by the utility in its MFRs were incorrect. We agree with our auditors and have used the corrected debt rates in setting the cost of capital. In addition, we find that the balance of deferred income taxes was omitted from the various capital structures of the subsidiaries. The appropriate average balance of accumulated deferred income taxes related to Sandalhaven corresponds to those amounts included in the income tax section of the MFRs. Thus, we find that deferred income taxes should be increased by \$17,937.

We shall use the current leverage formula approved by Order No. PSC-02-0898-PAA-WS, issued July 5, 2002, in Docket No. 020006-WS to calculate the ROE. Using an equity ratio of 45.48%, the utility's ROE is 10.93%, with a range of 9.93% to 11.93%.

Schedule 2 shows the components, amounts and cost rates associated with the capital structure for the test year. As addressed above, we find that adjustments should be made to include an allocated portion of the parent company's accumulated deferred ITCs and deferred income taxes, both at a zero-cost rate. The overall cost of capital shall be 5.72%, with a range of 5.49% to

5.96%, and the ROE shall be set at 10.93%, with a range of 9.93% to 11.93%.

B. AFUDC Rate

Sandalhaven does not have an approved AFUDC rate; nor did it request approval of such a rate in this proceeding. As previously noted, Rule 25-30.116(5), F.A.C., states that no utility may charge or change its AFUDC rate without our prior approval. However, Rule 25-30.116(7), F.A.C., states that we may, on our own motion, initiate a proceeding to revise a utility's AFUDC. Because the cost of capital is being updated in this proceeding, we find that a rate for AFUDC shall also be set. The incremental costs of approving an AFUDC rate in this docket are very minimal compared to the cost of a separate future filing for approval of an AFUDC rate.

As stated in Part IV, Section A, the cost of capital was set at 5.72%. Consistent with Rules 25-30.116(2) and (3), F.A.C., the annual AFUDC rate shall also be 5.72%, with a monthly discounted rate of 0.476756%. Further, Rule 25-30.116(5), F.A.C., states that the AFUDC rate shall be effective the month following the end of the period used to establish the rate. Because the test year ended December 31, 2001, was used to determine the cost of capital, the AFUDC rate shall be effective January 1, 2002. Schedule 2 shows cost of capital and resulting annual AFUDC rate.

V. NET OPERATING INCOME

A. Salaries and Payroll Taxes

Our auditors, in Audit Exception No. 9, noted that the utility made a pro forma adjustment in its MFRs to increase salary expense by \$15,751 to reflect 2002 salary levels. The MFRs show test year salaries of \$54,441. After adding the \$15,751 pro forma increase, the utility's total requested salary expense is \$70,192.

In its pro forma adjustment, the utility included annualized full-time salary levels for two employees that were actually part-time employees in 2001 and 2002. As a result of this error, the utility's salary expense was overstated. Our auditors also found that Sandalhaven's salaries for 2002 were lower than those in 2001, since some employees that had left the company were not replaced.

In order to test this, the auditors calculated the actual salary expense for 2002 through December 9, 2002. They then projected the amount to be expensed for the remaining three weeks of the calendar year. The revised 2002 salary expense calculated by the auditors totaled \$45,246, rather than the company-projected amount of \$70,192, a difference of \$24,946. The associated payroll tax expense overstatement on the \$24,946 salary expense was \$1,909.

The utility agreed that the two employees were part time and that the original pro forma increase was overstated. The utility prepared a revised schedule for the projected salaries of the two employees stating that the employees worked approximately 25 hours per week and were paid \$12.40 an hour. This resulted in annual salaries of \$32,240 for both employees, rather than the original company estimate of \$51,854. Based on its corrected analysis, the utility believes that the appropriate decrease to salaries should be \$19,614, ($\$51,854 - \$32,240$), rather than the \$24,946 recommended by our auditors.

The auditors' adjustment was based on 2002 actual salaries earned with an estimate for the last three weeks of 2002. The utility's projection only considered the two part-time employees and did not consider the overall salary reduction for employees no longer with the company. For this reason, we find that our auditor's adjustment is appropriate because it reflects the most current level of salaries. To only consider increased salary levels without reviewing those that have been reduced is improper. Salary expense shall be reduced by \$24,946 and a corresponding reduction of \$1,909 to the related payroll taxes shall also be removed.

Our auditors also found that several adjustments originally proposed in the Utilities, Inc. affiliated transactions audit should be made. In that audit, there were a number of recommended adjustments to WSC's O&M expense accounts. The affiliate transactions' audit report detailed the resulting allocation adjustments for each of the Utilities, Inc. systems, including Sandalhaven. The auditors in the present docket referenced those adjustments by stating that the allocated O&M expenses from WSC were \$2,032 higher than the properly allocated amount. This amount reflects the cumulative effects of the Affiliate Audit Exceptions 3,4,5,7,8, and 9. Further, the auditors recommended that payroll

taxes for WSC expenses be reduced by \$971. Because of the immaterial impact to Sandalhaven in this rate case, the utility has not disputed any of the exceptions in the affiliate transaction audit.

Based on the above, we find that salary expense shall be reduced by \$24,946 and associated payroll expense shall be reduced by \$1,909. In addition, due to allocation errors, allocated O&M expenses and payroll taxes shall be reduced by \$2,032 and \$971, respectively.

B. Miscellaneous Expenses

In Audit Exception No. 10, our auditors addressed four miscellaneous adjustments related to O&M expenses, discussed below. The utility did not provide a response to this exception.

First, the utility included 13 months of water bills in the 2001 test year purchased water account. The extra month was December 2000 and the expense was \$115. We find that the \$115 shall be removed.

The second adjustment deals with prior period miscellaneous expenses. The company accrued bills from Waste Management that included past due bills. The actual 2001 test year expense totaled \$797 for the year, instead of the \$1,295 that was recorded. Thus we find that a \$498 reduction to miscellaneous expenses shall be made.

The third adjustment addressed non-recurring and unsupported miscellaneous costs. The utility included \$83 for six months of prepaid costs that are fully amortized and will not be recurring. The amount in the test year totaled \$502. Also, the utility expensed \$167 monthly related to a prepaid invoice of \$2,000. According to our auditors, this invoice was requested, but never received. The auditors recommended that this unsupported amount be disallowed. We agree and find that \$2,502 be disallowed for these miscellaneous expenses.

The last adjustment in Audit Exception No. 10 deals with legal fees associated with the ownership of lines. The total invoice was \$7,019 and our auditors believe that this cost is non-recurring and

may need to be deferred. Pursuant to Rule 25-30.433(8), F.A.C., non-recurring expenses shall be amortized over a 5-year period unless a shorter or longer period can be justified. Accordingly, \$1,404 shall be allowed as a test year expense, and the remaining unamortized portion of \$5,615 shall be removed.

In summary, we find that the following adjustments to the utility's test year expenses shall be made:

Purchased Water - Prior Period	(\$115)
Miscellaneous - Prior Period	(498)
Miscellaneous - Non-recurring & Unsupported	(2,502)
Contractual Services Legal - Non-recurring	<u>(5,615)</u>
Total	<u><u>(\$8,730)</u></u>

C. Rate Case Expense

The utility included a \$120,000 estimate in the MFRs for current rate case expense. As part of our analysis, we requested an update of the actual rate case expense incurred, with supporting documentation, and the estimated amount to complete the case. The utility's revised, estimated rate case expense through completion of the proceeding was \$62,056. This included an increase of \$1,800 to consultant's fees for appraisal costs related to the determination of the proper value of utility land, discussed in Part III, Section C. The components of the estimated rate case expense are as follows:

	<u>MFR</u>		<u>Additional</u>	<u>Revised</u>
	<u>Estimate</u>	<u>Actual</u>	<u>Estimated</u>	<u>Estimate to</u>
				<u>Complete</u>
Filing Fee	\$2,000	\$2,000	\$0	\$2,000
Legal Fees	50,000	6,419	4,050	10,469
Consultant Fees	45,000	28,874	2,630	31,504
WSC In-house Fees	11,000	2,884	3,849	6,733
Miscellaneous Expense	<u>12,000</u>	<u>680</u>	<u>10,670</u>	<u>11,350</u>
Total Rate Case Expense	<u><u>\$120,000</u></u>	<u><u>\$40,857</u></u>	<u><u>\$21,199</u></u>	<u><u>\$62,056</u></u>

Pursuant to Section 367.081(7), Florida Statutes, we shall determine the reasonableness of rate case expenses and shall disallow all rate case expenses determined to be unreasonable. We examined the requested actual expenses, supporting documentation, and estimated expenses as listed above for the current rate case, and find that the revised estimate to complete the case is reasonable with two exceptions.

The first adjustment relates to cost incurred to correct deficiencies in the MFR filing. The utility states that its consultant incurred \$2,496 related to correcting the MFRs. We have previously disallowed rate case expense associated with correcting MFR deficiencies because of duplicate filing costs. See Order No. PSC-01-0326-FOF-SU, issued February 6, 2001, in Docket No. 991643-SU. Accordingly, we find that \$2,496 shall be removed as duplicative and unreasonable rate case expense.

The second adjustment relates to \$10,670 in estimated travel expenses for WSC employees. When reviewing the submitted invoices and estimates to complete, we realized that the utility did not submit any documentation for the \$11,350 in miscellaneous rate case expense. When requested, the utility provided documentation supporting \$430 in preparation and mailing costs for one customer notice and an additional \$250 for other miscellaneous mailing costs. The utility responded that the remaining \$10,670 related to estimated travel costs for a utility representative to travel to Florida at least once before the resolution of the case.

We find that the estimated travel expenses are not reasonable for several reasons. One, the travel cost appears excessive for one trip to Tallahassee and there are no breakdowns of the estimated travel costs to allow us to test for reasonableness. In addition, the travel costs are not required because the estimated costs already include the cost of the utility's consultant to prepare for and attend the agenda conference.

We note, however, that the utility's estimate does not include the costs for additional customer notices that are required. One notice recently went out for the implementation of interim rates and a second notice will be required for the PAA rates. Using the actual cost for one notice of \$430, we find that \$860 in additional

costs shall be added back to the utility's estimated rate case expense. Based on the above, we find that the miscellaneous expenses shall be reduced by \$9,810. This allows a total of \$1,540 for miscellaneous notice and mailing costs.

We find that the total rate case expense is \$49,750. A breakdown of the allowance of rate case expenses is as follows:

	<u>MFR</u> <u>Estimate</u>	<u>Utility</u> <u>Revised</u> <u>Actual &</u> <u>Estimated</u>	<u>Commission</u> <u>Adjustments</u>	<u>Total</u>
Filing Fee	\$2,000	\$2,000	\$0	\$2,000
Legal Fees	50,000	10,469	0	10,469
Consultant Fees	45,000	31,504	(2,496)	29,008
WSC In-house Fees	11,000	6,733	0	6,733
Miscellaneous Expense	<u>12,000</u>	<u>11,350</u>	<u>(9,810)</u>	<u>1,540</u>
Total Rate Case Expense	<u>\$120,000</u>	<u>\$62,056</u>	<u>(\$12,306)</u>	<u>\$49,750</u>
Annual Amortization	<u>\$30,000</u>		<u>(\$17,563)</u>	<u>\$12,438</u>

The rate case expense shall be amortized over four years, pursuant to Section 367.0816, Florida Statutes, at \$12,438 per year. Based on the data provided by the utility and the adjustments above, we find that the rate case expense shall be reduced by \$17,563. This is the difference between \$12,438 annual amortization and the \$30,000 included as expenses on MFR Schedule B-10.

D. Adjustments to Property Taxes

Audit Exception No. 11 notes that a \$6,893 payment of past due property tax was made in October 2001, and was included in the \$22,147 of real and personal property taxes shown in the MFRs. The utility did not respond to this exception. We find that these taxes shall be removed because they overstate the proper amount of test year taxes other than income.

E. Test Year Operating Income

As shown on attached Schedule 3-A, after applying the adjustments made to net operating income, net operating income for the test year is (\$14,405).

VI. REVENUE REQUIREMENT

Sandalhaven requested final rates designed to generate annual revenues of \$336,913. These revenues exceed test year revenues of \$221,904 by \$115,009 (or 51.83%).

Based upon rate base, cost of capital, and operating income, we approve rates that are designed to generate a revenue requirement of \$251,282. These revenues exceed the adjusted test year revenues by \$29,378 (or 13.24%) as shown on attached Schedule 3-A. This increase will allow the utility the opportunity to recover its expenses and earn a 5.72% return on its investment in rate base.

VII. RATES AND RATE STRUCTURE

A. General Service Customer Reclassification

The utility's tariff currently has a general service class labeled "1½ inch (15 ERC Restaurant)" and the utility collects this tariff from a restaurant in its territory. The customer currently has a 1½ inch meter, as issued by Charlotte County who provides water service to the area. As stated on its tariff, this is equivalent to 15 ERCs instead of the normal three ERCs that all other 1½ inch meter customers are charged. Thus, this customer is charged 5 times what all other 1½ inch metered customers are charged.

The utility explains that the account was set up under prior ownership and while under the rate jurisdiction of Charlotte County. The rate for this account was approved by Charlotte County and grandfathered in by us. The utility has no specific knowledge of why the 3-inch tariff rate was used for this account. One explanation offered by the utility was that a 3-inch base facility charge was used because that meter is equivalent to 15 ERCs and the restaurant was estimated to have a demand of 15 ERCs.

It is the utility's burden to show that this rate class is appropriate and not discriminatory. The answer that "it has always been that way" is insufficient. The utility has not provided any information to show that this customer produces more wastewater than any other 1½ inch-metered customer. Therefore, we find that this class of service shall be discontinued, and the customer shall be charged a tariff rate based on its 1½ inch meter size.

B. Monthly Service Rates

As discussed in Part VI, Section A, the appropriate revenue requirement is \$251,282. After excluding miscellaneous service charges of \$5,410, the revenue to be recovered through rates is \$245,872. Sandalhaven's current rate structure is the base facility charge and gallonage charge with an 8,000 gallon cap on residential customers. The utility's current rate structure does not contain a differential in the gallonage charge between residential and general service. This type of differential is designed to recognize that approximately 80% of the residential customer's water usage will not return to the wastewater system. For multi-family and general service customers, approximately 96% of water usage is returned. This wastewater gallonage rate differential is employed in wastewater rate settings and is widely recognized as an industry standard. Based on the above, we find that the gallonage rate differential shall be used in this case.

The utility shall file revised tariff sheets and a proposed customer notice to reflect the newly-approved rates. The newly-approved rates shall be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-40.475(1), F.A.C. The rates shall not be implemented until we have approved the proposed customer notice, and the notice has been received by the customers. The utility shall provide proof of the date notice was given within 10 days after the notice was given.

A comparison of the utility's original rates, requested rates and newly-approved rates is shown on attached Schedule 4.

C. Appropriate Reuse Rate

The utility entered into a contract with the Wildflower Golf & Country Club (Club) on March 13, 1995, to provide reuse to the Club at a rate of zero for 60 months from the date that reuse would be available (September 30, 1995). On November 7, 1997, the utility and Club entered into a contract for reuse modifying the March 13, 1995, contract. The November 7, 1997, contract included an annual fee of \$4,000 (to be paid in \$1,000 increments quarterly) which was intended to cover an unanticipated cost increase for testing and operating the reuse system. We discovered this charge while reviewing the utility's rate filing for this case. We notified the utility that this charge was not included in its tariffs. Subsequently, the utility requested approval of the quarterly reuse rate for the Club and provided First Revised Tariff No. 16.0 and Original Tariff No. 17.5 reflecting the quarterly reuse rate for the Club of \$1,000.

Section 367.091(3), Florida Statutes, specifies that each utility's rates, charges, and customer service policies must be contained in a tariff approved by and on file with us. Section 367.091(4), Florida Statutes, specifies that a utility may only impose and collect those rates and charges we approved for the particular class of service involved. Currently, the utility is charging the Club \$1,000 per quarter for reuse service. The utility does not have a tariffed reuse rate on file.

The Club is currently the utility's only reuse customer. According to responses to a data request, the Club is able to meet the utility's effluent disposal needs, and the utility has no plans to expand its reuse service to residential customers in the near future. The current rate that the utility is charging was agreed to by the Club. The Club is not a related party to the utility.

Generally, reuse rates cannot be determined in the same fashion as other water and wastewater rates set by the Commission. Reuse rates based on rate base and revenue requirements would typically be so high that it would be impractical to use reuse at all, based on the revenue needed to supply the service. When we consider recommending reuse rates, we must consider the type of customer being served and balance the disposal needs of the utility with the consumption needs of the customer. In this case, the only

reuse customer is the Club, and the utility does not plan on expanding its reuse service to residential customers in the near future.

Next, we looked at the disposal needs of the utility and customer. In cases where a utility has excess reuse capacity, rates typically would be set lower to promote reuse at a level sufficient to meet the utility's disposal needs. In cases where a utility's reuse capacity is unable to meet demand, rates would be set higher or rate structure would be changed in order to promote conservation. In this case, the Club is able to meet the needs of the utility's disposal and has agreed to a rate for accepting the reuse.

Based on the above, we find that a quarterly flat rate of \$1,000 is an appropriate rate for reuse service to the Club. The utility's proposed tariff to implement a reuse service rate is approved. First Revised Tariff Sheet No. 16.0 and Original Tariff Sheet No. 17.5 shall be approved as filed. The approved tariffs shall be effective for service rendered on or after the stamped approval date on the tariff sheets, pursuant to Rule 25-30.475(1), F.A.C.

D. Interim Refund

By Order No. PSC-02-1703-PCO-SU, issued on December 6, 2002, in this docket, we authorized the collection of interim wastewater rates, subject to refund. The approved interim revenue requirement is shown below:

<u>Revenue Requirement</u>	<u>Revenue Increase</u>	<u>Percentage Increase</u>
\$ 276,505	\$54,601	24.61%

According to Section 367.082, Florida Statutes, any refund shall be calculated to reduce the rate of return of the utility during the pendency of the proceeding to the same level within the range of the newly authorized rate of return. Adjustments made in the rate case test period that do not relate to the period interim rates are in effect shall be removed. The inclusion of a prospective attrition allowance or rate case expense is an example

of adjustments which are recovered only after final rates are established.

In this proceeding, the test period for establishment of interim and final rates is the twelve-month period ended December 31, 2001. Sandalhaven's approved interim rates did not include any provisions for pro forma, or projected, operating expenses or plant. The interim increase was designed to allow recovery of actual interest costs, and the floor of the last authorized range for equity earnings.

To establish the proper refund amount, we calculated a revised interim revenue requirement utilizing the same data used to establish final rates. Rate case expense was excluded because it was not an actual expense during the interim collection period.

Using the principles discussed above, the interim revenue requirement for the interim collection period is \$238,258 for wastewater. This revenue level is less than the interim revenue which was granted in Order No. PSC-02-1703-PCO-SU. Therefore, a refund of 14.11% of interim rates shall be made.

Thus, the utility shall refund 14.11% of wastewater revenues collected under interim rates. The refund shall also be made with interest in accordance with Rule 25-30.360(4), F.A.C. In addition, the utility shall submit refund reports pursuant to Rule 25-30.360(7), F.A.C. Finally, the utility shall treat any unclaimed refunds as CIAC pursuant to Rule 25-30.360(8), F.A.C.

E. Four Year Rate Reduction

Section 367.0816, Florida Statutes, requires that rates be reduced immediately following the expiration of the four-year amortization period for rate case expense, by the amount of the rate case expense included in the rates. The reduction will reflect the removal of revenues associated with the amortization of rate case expense and the gross-up for regulatory assessment fees which is \$13,024. The decreased revenues will result in the rate reduction shown on attached Schedule 4.

The utility shall file revised tariff sheets and a proposed customer notice to reflect the approved rates. The approved rates

shall be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-40.475(1), F.A.C. The rates shall not be implemented until we approve the proposed customer notice, and the notice has been received by the customers. The utility shall provide proof of the date notice was given no less than 10 days after the date the notice was given.

If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and/or pass-through increase or decrease, and for the reduction in the rates due to the amortized rate case expense.

OTHER ISSUES

A. Show Cause

The utility entered into a contract with the Wildflower Golf & Country Club (Club) on March 13, 1995, to provide reuse to the Club at a rate of zero for 60 months from the date that reuse would be available (September 30, 1995). On November 7, 1997, the utility and Club entered into a contract for reuse modifying the March 13, 1995, contract. The November 7, 1997, contract included an annual fee of \$4,000 (to be paid in \$1,000 increments quarterly), which was intended to cover the increase in cost for testing and operating the reuse system, which was not anticipated in the original contract. We discovered this charge while reviewing the utility's rate filing for this case, and notified the utility that this charge was not included in its tariffs. Subsequently, the utility requested approval of the quarterly reuse rate for the Club and provided a First Revised Tariff No. 16.0 and Original Tariff No. 17.5 reflecting the quarterly reuse rate for the Club of \$1,000.

Section 367.081(1), Florida Statutes, provides that a utility may only charge rates and charges approved by us. Section 367.091(3), Florida Statutes, provides that "each utility's rates, charges, and customer service policies must be contained in a tariff approved by and on file with the Commission." It appears that the utility violated these statutes.

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Schedule E-5 of the utility's rate case filing lists revenues for reuse contract charges of \$4,000. We did not approve a reuse rate for this utility and the utility does not have an approved reuse rate tariff on file. This collection of reuse charges was unauthorized, and thus was an apparent violation of Sections 367.081(1) and 367.091(3), Florida Statutes.

Section 367.161(1), Florida Statutes, authorizes the assessment of a penalty of not more than \$5,000 per day for each offense, if a utility is found to have knowingly refused to comply with, or to have willfully violated any Commission rule, order, or provision of Chapter 367, Florida Statutes.

We find that a show cause proceeding shall not be initiated at this time for several reasons. First, the revenue was properly recorded. Second, once the utility was informed, it promptly submitted a proposed tariff. Finally, we want to encourage reuse. However, the utility is on notice that, pursuant to Sections 367.081(1) and 367.091(3), Florida Statutes, it may only charge rates and charges that we have approved.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Utilities Inc. of Sandalhaven's Petition for Rate Increase is granted in part and denied in part as described herein. It is further

ORDERED that Utilities Inc. of Sandalhaven shall submit revised tariff sheets consistent with the rates approved herein, and that Commission staff shall administratively approve the tariff sheets. It is further

ORDERED that the provisions of this Order, except for the interim rate increase, the rate reduction after the expiration of the four-year amortization period for rate case expense, and the show cause decision are issued as proposed agency action. The provisions which are proposed agency action shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard

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Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that each of the findings made in the body of this Order is hereby approved in every respect. It is further

ORDERED that all matters contained in the attachments and schedules attached hereto are incorporated herein by reference. It is further

ORDERED that Utilities Inc. of Sandalhaven shall file revised tariff sheets and a proposed customer notice to reflect the approved rates. It is further

ORDERED that the rates shall not be implemented until staff has approved the proposed customer notice, and the notice has been received by the customers. It is further

ORDERED that the approved rates shall be effective for service rendered on or after the stamped approval date on the tariff sheets, pursuant to Rule 25-30.475(1), Florida Administrative Code, provided customers have received notice. The tariff sheets will be approved upon our staff's verification that the tariffs are consistent with this Order and the customer notice is adequate. It is further

ORDERED that in no event shall the rates be effective for service rendered prior to the stamped approval date. It is further

ORDERED that Utilities Inc. of Sandalhaven shall reduce its rates following the expiration of the four-year rate case expense recovery period pursuant to Section 367.0816, Florida Statutes. It is further

ORDERED that Utilities Inc. of Sandalhaven shall file revised tariff sheets and a proposed customer notice to reflect the approved lower rates and the reason for the reductions no later than one month prior to the actual date of the required rate reductions. It is further

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ORDERED that the approved lower rates shall be effective for service rendered on or after the stamped approval date of the revised tariff sheets pursuant to Rule 25-40.475(1), Florida Administrative Code. It is further

ORDERED that the approved lower rates shall not be implemented until our staff has approved the proposed customer notice, and the notice has been received by the customers. It is further

ORDERED that if Utilities Inc. Of Sandalhaven files this rate reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and/or pass-through increase or decrease, and for the reduction in the rates due to the amortized rate case expense. It is further

ORDERED that if there is no timely protest to the portion of our proposed agency action pertaining to the lower rates by a substantially affected person, Utilities Inc. of Sandalhaven shall file the appropriate revised tariff sheets, and a proposed notice within twenty days of the effective date of the proposed agency action Order. It is further

ORDERED that the revised tariff sheets for the lower rates shall be approved administratively upon staff's verification that the tariffs are consistent with our decision and the utility's proposed notice is adequate. It is further

ORDERED that for all notices required by this Order, Utilities Inc. of Sandalhaven shall provide proof of the date notice was given within 10 days after the date of the notice. It is further

ORDERED that if no person whose substantial interests are affected by the proposed agency action files a protest within twenty-one days of the issuance of this Order, a Consummating Order will be issued. It is further

ORDERED that this docket shall remain open for our staff's verification that the revised tariff sheets and notices have been filed and approved, but may then be administratively closed. It is further

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ORDERED that upon the issuance of a Consummating Order the funds in the escrow account for the interim revenues may be released to the utility and the escrow account may be closed.

By ORDER of the Florida Public Service Commission this 13th Day of May, 2003.

BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records and Hearing
Services

(S E A L)

MKS

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

As identified in the body of this order, our action, except for the interim rate increase, the rate reduction after the expiration of the four-year amortization period for rate case

expense, and the show cause decision, is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of the Commission Clerk and Administrative Services, at 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on June 3, 2003. If such a petition is filed, mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing. In the absence of such a petition, this order shall become effective and final upon the issuance of a Consummating Order.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

Any party adversely affected by the Commission's final action in this matter may request: (1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of the Commission Clerk and Administrative Services within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or (2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of the Commission Clerk and Administrative Services and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

UTILITIES, INC. OF SANDALHAVEN SCHEDULE OF WASTEWATER RATE BASE TEST YEAR ENDED 12/31/01			SCHEDULE 1-A DOCKET 020409-SU		
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	PSC ADJUST- MENTS	PSC ADJUSTED TEST YEAR
1 UTILITY PLANT IN SERVICE	\$1,685,206	\$0	\$1,685,206	(\$96,582)	\$1,588,624
2 LAND	225,000	0	225,000	(190,000)	35,000
3 NON-USED & USEFUL COMPONENTS	0	(120,350)	(120,350)	120,350	0
4 CONSTRUCTION WORK IN PROGRESS	8,546	(8,546)	0	0	0
5 ACCUMULATED DEPRECIATION	(565,289)	0	(565,289)	(50,741)	(616,030)
6 CIAC	(1,607,051)	0	(1,607,051)	0	(1,607,051)
7 AMORTIZATION OF CIAC	544,039	47,715	591,754	35,128	626,882
8 ACQUISITION ADJUSTMENTS - NET	448,387	(448,387)	0	0	0
9 WORKING CAPITAL ALLOWANCE	<u>0</u>	<u>29,531</u>	<u>29,531</u>	<u>(2,908)</u>	<u>26,623</u>
RATE BASE	<u>\$738,838</u>	<u>(\$500,037)</u>	<u>\$238,801</u>	<u>(\$184,753)</u>	<u>\$54,048</u>

UTILITIES, INC. OF SANDALHAVEN		SCHEDULE 1-B
ADJUSTMENTS TO RATE BASE		DOCKET 020409-SU
TEST YEAR ENDED 12/31/01		
EXPLANATION		WASTEWATER
<u>PLANT IN SERVICE</u>		
1	Removal of Organization Costs	(\$76,921)
2	Removal of Franchise Costs	(23,241)
3	Add allocated WSC Plant	12,208
4	Remove capitalized AFUDC	<u>(8,628)</u>
5	Total	<u>(\$96,582)</u>
<u>LAND</u>		
	Reduction for adjusted value	<u>(\$190,000)</u>
<u>NON-USED AND USEFUL</u>		
	Reflect net non-used and useful adjustment	<u>\$120,350</u>
<u>ACCUMULATED DEPRECIATION</u>		
1	Correction for incorrect rates	(\$84,433)
2	Remove AFUDC accumulated depreciation	(432)
3	Remove for Organization	20,866
4	Remove for Franchise	13,258
5	Total	<u>(\$50,741)</u>
<u>ACCUM. AMORT. OF CIAC</u>		
	Increase for error	<u>\$35,128</u>
<u>WORKING CAPITAL</u>		
	To reduce to 1/8 O&M Expense	<u>(\$2,908)</u>

UTILITIES, INC. OF SANDALHAVEN CAPITAL STRUCTURE-SIMPLE AVERAGE TEST YEAR ENDED 12/31/01						SCHEDULE 2 DOCKET 020409-SU	
DESCRIPTION	TOTAL CAPITAL	SPECIFIC ADJUST- MENTS (EXPLAIN)	PRO RATA ADJUST- MENTS	CAPITAL RECONCILED TO RATE BASE	RATIO	COST RATE	WEIGHTED COST
PER UTILITY							
1 LONG TERM DEBT	\$72,051,803	\$0	(\$71,948,438)	\$103,365	43.28%	8.82%	3.82%
2 SHORT-TERM DEBT	15,659,000	0	(15,636,545)	22,455	9.40%	2.54%	0.24%
3 PREFERRED STOCK	0	0	0	0	0.00%	0.00%	0.00%
4 COMMON EQUITY	73,169,033	0	(73,064,076)	104,957	43.95%	11.14%	4.90%
5 CUSTOMER DEPOSITS	8,025	0	0	8,025	3.36%	6.00%	0.20%
6 DEFERRED INCOME TAXES	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
7 TOTAL CAPITAL	<u>\$160,887,861</u>	<u>\$0</u>	<u>(\$160,649,059)</u>	<u>\$238,802</u>	<u>100.00%</u>		<u>9.15%</u>
PER STAFF							
8 LONG TERM DEBT	\$72,051,803	\$0	(\$72,039,225)	\$12,578	23.27%	8.71%	2.03%
9 SHORT-TERM DEBT	15,659,000	0	(\$15,656,266)	2,734	5.06%	4.38%	0.22%
10 PREFERRED STOCK	0	0	\$-0	0	0.00%	0.00%	0.00%
11 COMMON EQUITY	73,169,033	0	(\$73,156,260)	12,773	23.63%	10.93%	2.58%
12 CUSTOMER DEPOSITS	8,025	0	0	8,025	14.85%	6.00%	0.89%
13 DEFERRED INCOME TAXES	<u>0</u>	<u>17,937</u>	<u>0</u>	<u>17,937</u>	<u>33.19%</u>	0.00%	<u>0.00%</u>
15 TOTAL CAPITAL	<u>\$160,887,861</u>	<u>\$17,937</u>	<u>(\$160,851,750)</u>	<u>\$54,048</u>	<u>100.00%</u>		<u>5.72%</u>
					LOW	HIGH	
					9.93%	11.93%	
					5.49%	5.96%	

UTILITIES, INC. OF SANDALHAVEN STATEMENT OF WASTEWATER OPERATIONS TEST YEAR ENDED 12/31/01		SCHEDULE 3-A DOCKET 020409-SU					
DESCRIPTION	TEST YEAR PER UTILITY	UTILITY ADJUST- MENTS	ADJUSTED TEST YEAR PER UTILITY	PSC ADJUST- MENTS	PSC ADJUSTED TEST YEAR	REVENUE INCREASE	REVENUE REQUIREMENT
1 OPERATING REVENUES	<u>\$221,904</u>	<u>\$115,009</u>	<u>\$336,913</u>	<u>(\$115,009)</u>	<u>\$221,904</u>	<u>\$29,378</u> 13.24%	<u>\$251,282</u>
OPERATING EXPENSES							
2 OPERATION & MAINTENANCE	\$228,069	\$38,182	\$266,251	(\$53,271)	\$212,981		\$212,981
3 DEPRECIATION	4,507	(4,990)	(483)	6,526	6,043		6,043
4 AMORTIZATION	0	0	0	0	0		0
5 TAXES OTHER THAN INCOME	37,964	4,537	42,501	(14,948)	27,553	1,322	28,875
6 INCOME TAXES	<u>(32,307)</u>	<u>39,078</u>	<u>6,771</u>	<u>(17,038)</u>	<u>(10,267)</u>	<u>10,557</u>	<u>291</u>
7 TOTAL OPERATING EXPENSES	<u>\$238,233</u>	<u>\$76,807</u>	<u>\$315,040</u>	<u>(\$78,731)</u>	<u>\$236,309</u>	<u>\$11,879</u>	<u>\$248,189</u>
8 OPERATING INCOME	<u>(\$16,329)</u>	<u>\$38,202</u>	<u>\$21,873</u>	<u>(\$36,278)</u>	<u>(\$14,405)</u>	<u>\$17,498</u>	<u>\$3,093</u>
9 RATE BASE	<u>\$738,838</u>		<u>\$238,801</u>		<u>\$54,048</u>		<u>\$54,048</u>
10 RATE OF RETURN	<u>(2.21%)</u>		<u>9.16%</u>		<u>(26.65%)</u>		<u>5.72%</u>

UTILITIES, INC. OF SANDALHAVEN ADJUSTMENTS TO OPERATING INCOME TEST YEAR ENDED 12/31/01		SCHEDULE 3-B DOCKET 020409-SU
EXPLANATION	WASTEWATER	
<u>OPERATING REVENUES</u>		
Remove requested final revenue increase		<u>(\$115,009)</u>
<u>OPERATION & MAINTENANCE EXPENSE</u>		
1 Remove out of period water expense		(\$115)
2 Correction of error of waste management expense		(498)
3 Reduction of amortized prepaid expenses		(2,502)
4 Amortize non-recurring legal fees		(5,615)
5 Overstated pro forma salary		(24,946)
6 Reduce WSC allocated operating expenses		(2,032)
7 Reduction to rate case expense amortization		<u>(17,563)</u>
Total		<u>(\$53,271)</u>
<u>DEPRECIATION EXPENSE-NET</u>		
1 Remove organization depreciation expense		(\$1,920)
2 Remove franchise depreciation expense		(580)
3 Remove AFUDC depreciation expense		(452)
4 Correction of depreciation rates		15,949
5 Correction of amortization of CIAC rates		(11,461)
6 Remove non-used and useful adjustment		<u>4,990</u>
Total		<u>\$6,526</u>
<u>TAXES OTHER THAN INCOME</u>		
1 RAFs on revenue adjustments above		(\$5,175)
2 Payroll tax reduction for overstated pro forma		(1,909)
3 Reduce WSC allocated payroll taxes		(971)
4 Remove prior year payment of property tax		<u>(6,893)</u>
Total		<u>(\$14,948)</u>
<u>INCOME TAXES</u>		
To adjust to test year income tax expense		<u>(\$17,038)</u>

UTILITIES, INC. OF SANDALHAVEN					SCHEDULE 4
WASTEWATER MONTHLY SERVICE RATES					DOCKET 020409-SU
TEST YEAR ENDED 12/31/01					
	<u>Rates</u> Prior to <u>Filing</u>	<u>Commission</u> Approved <u>Interim</u>	<u>Utility</u> Requested <u>Final</u>	<u>Comm.</u> Approved <u>Final</u>	<u>4-Year</u> Rate <u>Reduction</u>
<u>Residential</u>					
Base Facility Charge:					
All meter sizes	\$12.00	\$15.03	\$18.40	\$12.24	\$0.63
Gallonage Charge (per 1,000 gallons)					
8,000 gallon cap	\$2.59	\$3.24	\$3.97	\$3.44	\$0.18
<u>Multi-Family</u>					
Base Facility Charge:					
All meter sizes	\$12.00	\$15.03	\$18.40	\$12.24	\$0.63
Gallonage Charge (per 1,000 gallons)	\$2.59	\$3.24	\$3.97	\$4.13	\$0.21
<u>General Service</u>					
Base Facility Charge:					
Meter Size:					
5/8" x 3/4"	\$12.00	\$15.03	\$18.40	\$12.24	\$0.63
1"	\$30.00	\$37.57	\$46.01	\$30.61	\$1.59
1-1/2"	\$60.00	\$75.13	\$92.02	\$61.21	\$3.17
1-1/2" (15 ERC Restaurant)**	\$180.00	\$225.39	\$276.07	\$0.00	\$0.00
2"	\$96.00	\$120.21	\$147.24	\$97.94	\$5.08
3"	\$180.00	\$225.39	\$276.07	\$183.63	\$9.52
4"	\$300.00	\$375.66	\$460.12	\$306.05	\$15.86
6"	\$600.00	\$751.31	\$920.24	\$612.10	\$31.72
Gallonage Charge, per 1,000 Gallons	\$2.59	\$3.24	\$3.97	\$4.13	\$0.21
** This class of service was discontinued.					
<u>Typical Residential Bills</u>					
5/8" x 3/4" meter					
3,000 Gallons	\$19.77	\$24.75	\$30.31	\$22.57	\$1.17
5,000 Gallons	\$24.95	\$31.23	\$38.25	\$29.45	\$1.53
8,000 Gallons	\$32.72	\$40.95	\$50.16	\$39.78	\$2.06
(Wastewater Gallonage Cap - 8,000 Gallons)					